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No. 48

In the Supreme Court of the United States

OCTOBER TERM, 1946

WALTER J. ROTHENSIES, INDIVIDUALLY AND AS UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA, PETITIONER

v.

THE ELECTRIC STORAGE BATTERY COMPANY, A CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE PETITIONER

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OPINIONS BELOW

The opinion of the District Court (R. 37) is reported in 57 F. Supp. 731. The opinion of the Circuit Court of Appeals (R. 48) is reported in 152 F. 2d 521.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on November 27, 1945. (R. 55.) The petition for a writ of certiorari was filed on February 26, 1946, and was granted on March

25, 1946. (R. 56, 57.) The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

The taxpayer in 1935 received a refund of excise taxes for periods from July, 1922, to April, 1926, and thereafter paid income taxes for the year 1935 with respect to that refund. Those income taxes were held herein to have been properly imposed. Nevertheless, the courts below awarded the taxpayer a refund of those 1935 income taxes from the Collector of Internal Revenue to whom they were paid, on the ground that similar excise taxes which the taxpayer had erroneously paid to predecessor Collectors for periods between 1919 and 1922 (the refund of which had been barred by limitations as early as 1926) should have been offset against the 1935 income taxes on the principle of recoupment. The questions presented are:

(1) Whether equitable principles of recoupment are applicable.

(2) Whether in any event Sections 608–610 of the Revenue Act of 1928 preclude a recoupment of the barred excise taxes.

(3) Whether in this suit against the Collector for refund of income taxes paid to such Collector, the taxpayer may recoup excise taxes paid to this Collector's predecessors in office.

STATUTES INVOLVED

The pertinent provisions of the statutes involved are set out in the Appendix, *infra*, pp. 42–50.

STATEMENT

The facts as stipulated (R. 21–29) and as found by the District Court (R. 30–36, 45) may be summarized as follows:

During the period between April 28, 1919, and June 27, 1922, inclusive, the taxpayer paid excise taxes on sales of storage batteries in the net amount of $912,978.57 for which no claim for refund was ever filed or allowed. (R. 27, 28–29.) The excise taxes so paid were taken as deductions by the taxpayer in its federal income tax returns for the years 1919 to 1922, inclusive, and through the deduction thereof taxpayer secured a substantial tax benefit. (R. 28, 29.) During such period the taxpayer made monthly returns of excise taxes in which it reported sales of its storage batteries and it paid such excise taxes to the then Collectors of Internal Revenue for the First District of Pennsylvania, who were the predecessors in office of Walter J. Rothensies, the Collector named in this suit. (R. 27.)

During the period between July, 1922, and April, 1926, inclusive, the taxpayer paid similar excise taxes in the amount of $825,151.52 on sales of storage batteries, which excise taxes were taken as deductions in the taxpayer's income tax returns for the years 1922 to 1926, inclusive, and so re-

resulted in a tax benefit to it of $139,668.83, exclusive of interest, or the sum of $305,335.07, including interest to June 5, 1944.[1] (R. 22, 23.) On July 19, 1926, the taxpayer filed a timely claim for refund of the excise taxes paid in the amount of $825,151.52 for the period between 1922 and 1926. (R. 23.) Following the rejection of its claim for refund, the taxpayer instituted suit in the United States District Court for the Eastern District of Pennsylvania against the then Collector of Internal Revenue, and secured a judgment in that court for a refund of $1,416,567.81, and in 1933 the Circuit Court of Appeals for the Third Circuit affirmed the judgment. *McCaughn* v. *Electric Storage Battery Co.*, 63 F. 2d 715. (R. 23–25, 31.) The Government subsequently declined to pay the judgment on the ground that the taxpayer had not established that it had borne the burden of the tax, and that under the decision in the case of *Routzahn* v. *Willard Storage Battery Co.*, 291 U. S. 386, no recovery was allowable. (R. 25.) However, after prolonged negotiations the taxpayer agreed in 1935 to accept the payment of $1,395,515.35 of which $825,151.52 represented tax, and the balance represented interest. (R. 25, 31.)

In its income tax return for the year 1935 the taxpayer reported as income only the portion of

[1] June 5, 1944 was the date of the stipulation of facts herein upon the basis of which the District Court made its findings (R. 29). It has no other significance.

the interest accrued on the refund of excise taxes during the year 1935. (R. 25.) The Commissioner of Internal Revenue held that the refund of tax in the amount of $825,151.52 and the whole amount of interest thereon was taxable as income for the year 1935 and accordingly assessed an additional income and excess profits tax against the taxpayer for that year, which, together with interest, amounted to $229,805.34. (R. 26.) On December 5, 1938, the taxpayer paid that deficiency and interest, and on November 30, 1940, it filed a claim for refund. Upon the rejection of its claim, it brought this suit against Collector Rothensies who was the Collector in 1938 at the time the deficiency was paid. (R. 21, 26.) The taxpayer contended in its claim for refund and in its suit that the amounts added by the Commissioner to its taxable income for the year 1935 were not income at all and if they were, it could not be taxed therefor in the year 1935; and, in the alternative, it maintained that if the assessment of the additional taxes for the year 1935 was correct, then it should be permitted to recoup the amount of the excise taxes collected from it between 1919 and 1922. (R. 2–7, 9–16.)

The District Court held that the deficiency in 1935 income and excess profits tax was properly determined and assessed, but that the taxpayer had a right to recoupment equal to the amount of the excise taxes collected from it between 1919

and 1922, less the tax benefit derived from the deduction of such excise taxes in its income tax returns for the years 1919 to 1922, inclusive, including interest. Accordingly, the District Court rendered judgment for the amount sued for plus interest. (R. 37–45.)

The Circuit Court of Appeals affirmed the judgment of the District Court, agreeing with that court that the deficiency in 1935 income and excess profits tax was properly assessed but that the taxpayer had a right to recoup the barred excise taxes for the years 1919 to 1922. (R. 48–56.)

SPECIFICATIONS OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

(1) In holding that, in the suit for refund of income taxes for 1935 properly imposed upon a refund of excise taxes erroneously paid on sales of storage batteries, the taxpayer may recoup excise taxes erroneously paid in earlier periods on other sales of storage batteries, the refund of which is barred by the statute of limitations.

(2) In holding that excise taxes erroneously paid on sales of storage batteries over the periods from 1919 to 1922 arose out of the same transaction within the principle of recoupment as income taxes imposed on the refund of similar excise taxes erroneously paid for later years.

(3) In holding that the limitations in the Revenue Act of 1928 are applicable only to the Gov-

ernment and do not preclude the taxpayer from recouping the barred excise taxes in the suit for refund of income taxes.

(4) In holding that the right to recoupment is a substantive right which vested in the taxpayer when the excise taxes were paid in the years 1919 to 1922, and that Sections 608 and 609 should not be interpreted to cut off this right.

(5) In holding that, in the suit against a Collector of Internal Revenue for refund of income taxes paid to such Collector, the taxpayer may recoup excise taxes paid to that Collector's predecessors in office.

(6) In affirming the judgment of the District Court.

SUMMARY OF ARGUMENT

I

The court below in sustaining a recovery by the taxpayer of correctly determined and assessed income taxes for the year 1935 upon the ground that the taxpayer was entitled to a recoupment of excise taxes, which were not legally refundable because of the statute of limitations, has granted relief to the taxpayer not permitted under the statutory scheme for the recovery of taxes.

The system of corrective justice in respect of the assessment and collection of erroneous or illegal taxes requires that all claims for the refunding or crediting of any internal revenue tax alleged to have been erroneously assessed or collected be presented to the Commissioner of Internal Revenue within a prescribed period of

time and prohibits the refunding or crediting of such taxes or the bringing of suit therefor unless claim is filed within the period prescribed.

In this case the recovery by the taxpayer of the excise taxes for the period from 1919 to June 1922, which the taxpayer seeks to recoup, is barred by the statute of limitations inasmuch as the taxpayer has never filed a claim for refund or credit of those taxes, and the time within which such a claim could be filed has long since expired. Indeed, the refund of the 1919–1922 excise taxes had been barred even before July 19, 1926 when the taxpayer filed its claim for refund of its 1922–1926 excise taxes.

The court below has held that the income taxes for 1935, which are the only taxes that the present suit purportedly seeks to recover, were correctly determined and assessed. There is no provision of law requiring or permitting the Commissioner or the Collector to reduce a correct assessment of taxes by the amount of an overpayment of taxes which is barred from refund or credit by the statute of limitations, and accordingly the Collector was under a statutory duty to collect the assessment of 1935 income taxes. The determination, assessment and collection of the 1935 income taxes were neither erroneous nor invalid, and such taxes may not be recovered by suit.

The doctrine of *Bull* v. *United States*, 295 U. S. 247, is inapplicable to this case because the barred excise taxes for 1919–1922, sought to be

recouped, did not arise out of the same transaction as the income taxes for 1935, and for the further reason that the claim to recover those taxes was not alive when proceedings were instituted to collect the 1935 tax. The income taxes for 1935 were imposed upon a refund of excise taxes for 1922 to 1926 for which a timely refund claim had been filed and suit brought. The only pertinent transaction in 1935 was the refund. The recoupment claim had no relationship to the refund save the totally irrelevant fact that the refund and the recoupment claim had a common origin in excise taxes paid upon the manufacture and sale of storage batteries. But they were not even the same batteries. The recoupment principle is not to be applied to distinct transactions merely because they grow out of earlier transactions which were unrelated though similar.

II

In *McEachern* v. *Rose*, 302 U. S. 56, this Court held that Sections 607 and 609 (a) of the Revenue Act of 1928 precluded the Government from defeating a recovery of an overpayment of taxes by recoupment of a barred deficiency. If this Court adheres to that decision, then Sections 608 and 609 (b), which parallel Sections 607 and 609 (a), preclude the taxpayer from recovering a correctly assessed tax by recoupment of a barred overpayment of other taxes. There is no basis in the wording or the legislative history of Sections 607–609 to justify the conclusion of the court

below that the limitations apply only against the Government, nor is there any public policy which would warrant that conclusion. Whatever limitations are contained in those sections are not restricted to cases arising after the passage of the Revenue Act of 1928.

III

This Court has held that suits against Collectors of Internal Revenue are personal. The excise taxes which the taxpayer seeks to recoup were paid to the predecessors in office of the Collector against whom the present suit was brought. There has been strict compliance with the law by the Commissioner and by the Collector in respect of the 1935 income taxes sought to be recovered. In permitting a recovery of those taxes because of the erroneous collection of the excise taxes, the court below has allowed a personal judgment to be obtained against one Collector because of payments made to a different Collector, which is a result forbidden by this Court's decisions.

ARGUMENT

I

RECOVERY BY THE TAXPAYER IN THIS CASE MAY NOT BE SUPPORTED UPON EQUITABLE PRINCIPLES OF RECOUPMENT

The present suit by the taxpayer seeks the recovery of income taxes for the year 1935 imposed upon the refund in that year of excise taxes paid by the taxpayer from June 1922 to 1926 upon the

sale of storage batteries. The complaint sets forth two causes of action. The first cause of action (R. 2–6) alleges that the assessment of the 1935 income taxes was erroneous because the refund of the 1922–1926 excise taxes was not income and because the income, if any, other than a small amount of the interest, had not accrued in the year 1935. The second cause of action (R. 6–7), assuming the correctness of the 1935 income tax assessment, alleges that it is the right of the taxpayer to have set off or recouped against that assessment excise taxes paid on the sale of [redacted] from 1919 to June 1922, which could not be legally refunded because of the bar of the statute of limitations.

The court below has correctly held that the refund of the excise taxes in 1935 constituted income in that year to the taxpayer,[2] that the

[2] No issue is raised in the petition for certiorari with respect to the holding below that the refund constituted income to the taxpayer. The point is discussed in detail in the opinion of the District Court (R. 38–42), and the conclusion of that court, concurred in by the Circuit Court of Appeals, is plainly correct. *Houbigant, Inc.* v. *Commissioner*, 31 B. T. A. 954, affirmed, 80 F. 2d 1012 (C. C. A. 2d), certiorari denied, 298 U. S. 669; *Union Trust Co.* v. *Commissioner*, 39 B. T. A. 338, affirmed, 111 F. 2d 60 (C. C. A. 7th), certiorari denied, 311 U. S. 658; *Hoboken Land & Improvement Co.* v. *Commissioner*, 46 B. T. A. 495, 502–506, affirmed, 138 F. 2d 104 (C. C. A. 3d); *Freihofer Baking Co.* v. *Commissioner*, 151 F. 2d 383 (C. C. A. 3d); cf. *Griffiths* v. *Commissioner*, 308 U. S. 355, 357; *Dobson* v. *Commissioner*, 320 U. S. 489, 505. A benefit was derived by the taxpayer, through the deduction in its income tax returns for 1922 to 1926 of the excise taxes paid from June 1922 to 1926, which was approximately equal

income taxes sought to be recovered were properly determined and assessed, and accordingly that the taxpayer is not entitled to a recovery under its first cause of action.

However, the court has sustained, under the second cause of action, a recovery by the taxpayer of the income taxes in suit upon the theory that the taxpayer is entitled to recoup the barred excise taxes paid by it from 1919 to June 1922.[3] In thus sustaining recovery in this case we submit the court below has erred.

1. THERE IS NO STATUTORY AUTHORITY FOR THE ALLOWANCE OF REFUND HERE ON EQUITABLE PRINCIPLES

Section 3228 of the Revised Statutes, as amended (Appendix, *infra*, p. 50), provides that all claims for the refunding or crediting of any internal revenue tax alleged to have been erroneously or illegally assessed or collected must (except as otherwise provided by law in the

to the income taxes imposed upon the refund of those excise taxes. (R. 23.) The income attributable to the recovery of the excise taxes may not, therefore, be excluded from gross income under the amendments to the Internal Revenue Code and prior Revenue Acts made by Section 116, Revenue Act of 1942, c. 619, 56 Stat. 798, 812.

[3] The excise taxes paid by the taxpayer over the periods from 1919 to 1926 were imposed under similar statutory provisions upon the basis that the electric storage batteries manufactured and sold by the taxpayer were automobile parts or accessories. Those paid from 1919 to June 1922 were under Section 900 of the Revenue Act of 1918, c. 18, 40 Stat. 1057, and the Revenue Act of 1921, c. 136, 42 Stat. 227; and those paid from June 1922 to 1926 were under Section 900 of the Revenue Act of 1921, *supra*, and Section 600 of the Revenue Act of 1924, c. 234, 43 Stat. 253. (R. 22, 27.)

case of income, war profits, excess profits, estate and gift taxes) be presented to the Commissioner of Internal Revenue within four years next after the payment of such tax. That section further provides that the amount of the refund shall not exceed the portion of the tax paid during the four years immediately preceding the filing of the claim, or if no claim was filed, then during the four years immediately preceding the allowance of the refund.

Section 3226 of the Revised Statutes (Appendix, *infra*, pp. 49–50) provides that no suit shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected until appeal shall have been duly made to the Commissioner of Internal Revenue according to the provisions of law in that regard.

These sections form part of a system of corrective justice in respect of the assessment and collection of erroneous or illegal taxes. This system, developed through long years of experience, was intended to comprehend the entire subject, including all claims for refund. *United States* v. *Jefferson Electric Co.* 291 U. S. 386, 395, 396. The system was summarized in that case as follows (pp. 395–396):

> Anterior to collection the Commissioner possesses exclusive authority to revise, correct or reject assessments and the courts are forbidden to entertain suits "to re-

> strain the assessment or collection." After collection aggrieved taxpayers are accorded a limited time within which to apply for refunds, and the Commissioner is authorized to grant the applications where the taxes are shown to have been erroneous or illegal; but a denial by him is not final. If the application is either denied or not acted on by the Commissioner the taxpayer is accorded a fixed period within which to bring suit for a refund against the United States or the collector who received the tax, and if in the suit he establishes that the tax was erroneous or invalid, that it was paid by him, and that his claim has been duly and seasonably presented and prosecuted, he is entitled to judgment for a refund of the amount paid with interest.

The statutory requirement of the filing of a claim with the Commissioner as a prerequisite to suit was designed to protect the Government against stale demands and to secure an orderly administration of the revenue. The claim for refund which is required as a prerequisite to suit relates to the claim which may be asserted by the suit. Compliance with the statute, requiring the presentation of the claim within a given period of time, is mandatory and may not be waived by either the Collector or the United States. *United States* v. *Felt & Tarrant Co.*, 283 U. S. 269; *Rock Island R. R. Co.* v. *United States*, 254 U. S. 141; *United States* v. *Garbutt Oil Co.*, 302

U. S. 528, 533–534; *Angelus Milling Co.* v. *Commissioner*, 325 U. S. 293, 296.

In the present case the latest date upon which a claim for refund could have been filed to recover any of the excise taxes for the periods from 1919 to June 1922 expired in 1926. Taxpayer never filed a claim for refund of those taxes, and no suit was instituted by it for the recovery of those taxes because of the bar of the statute of limitations. The refund of those taxes had been barred as early as July 1926 when the taxpayer filed its claim for the recovery of its excises for the period July 1922–April 1926. (R. 28–29.) Indeed, the taxpayer alleges in its complaint (R. 6–7) that the amount of those taxes for 1919 to 1922 was not legally refundable to it by reason of the fact that the statute of limitations intervened as a bar against the filing of claim for refund therefor.

The theory of taxpayer's second cause of action, sustained below, is that there was an illegal collection by Collector Rothensies of the income taxes for 1935 because no effect was given to the alleged right of recoupment of the barred 1919–1922 excise taxes. However, in 1938 when the 1935 deficiency was collected, no claim for refund or credit of the 1919–1922 excises had been filed, and no timely claim for refund or credit could have been filed for over 12 years. There is no statutory provision requiring or permitting the Commissioner of Internal Revenue or a Collector

of Internal Revenue to decline to collect a valid assessment on equitable grounds or to credit against a valid assessment of taxes an overpayment of other taxes which is not legally refundable.[4] Section 3228 in itself indicates that there is no such authority and as pointed out hereinafter (*infra*, pp. 30–38), Sections 608 and 609 of the Revenue Act of 1928 (Appendix, *infra*, pp. 42–43) declare that such an attempt would be void. When Collector Rothensies received from the Commissioner the assessment list with the valid assessment for the additional income taxes for 1935 he was under a statutory duty to collect the assessment.[5]

Suits for the recovery of taxes are a means for testing the legal sufficiency and correctness of the

[4] This is particularly true in the present case because the payment alone of the improperly exacted excise taxes would not have provided a basis for the credit or refund of those taxes even if there had been a timely filed claim for refund. Section 424 (a) of the Revenue Act of 1928, c. 852, 45 Stat. 791, 866, made the right to a refund of the automobile accessories excise tax depend upon a showing by the taxpayer that he had not collected the tax, directly or indirectly, from the purchaser, or, if it was so collected, that the taxpayer had returned the tax to the purchaser. These were matters which the taxpayer must have shown by suitable allegation and have established by appropriate proof. *United States* v. *Jefferson Electric Co.*, *supra*.

Thus in the present case, although the taxpayer paid $912,978.57 of excise taxes on storage batteries from 1919 to June 1922 (R. 6, 28), only $534,205.04 of these taxes were absorbed by it and the remaining amount was passed on to the purchasers of the batteries (R. 33).

[5] Revised Statutes, Sec. 3182; *Moore Ice Cream Co.* v. *Rose*, 289 U. S. 373, 381.

administrative action whereby those taxes were determined and collected. The courts have not been vested with general jurisdiction to grant a refund of taxes upon equitable principles where the taxes have been exacted according to law.[6] With respect to the determination, assessment and collection of the income taxes for 1935, there has been strict compliance by the Commissioner and by the Collector with all provisions of law in that regard. It would appear to follow that there could be no recovery by suit of those taxes.

The taxpayer nevertheless maintains that it has a right of recovery of the income taxes for 1935 under the principle of recoupment as developed by this Court in *Bull* v. *United States*, 295 U. S. 247, even in the absence of any statutory provision requiring or permitting the Commissioner or the Collector to reduce the correct assessment of income taxes for the year 1935 by the amount of barred and non-refundable excise taxes for 1919 to 1922. In upholding this contention of the taxpayer, the court below has, we submit, erroneously applied the doctrine of the *Bull* case.

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[6] *Cheatham* v. *United States*, 92 U. S. 85. In *Graham & Foster* v. *Goodcell*, 282 U. S. 409, this Court, in rejecting the contention that Sections 607 and 611 of the Revenue Act of 1928 related solely to administrative action and not to judicial proceedings, said (p. 423):

> It would be anomalous that the right of the taxpayer to obtain a refund from the Department, to which he was under obligation to resort (R. S. 3226, U. S. C. Tit. 26, sec. 156), should be denied, while the right to recover by suit the same amount under exactly the same circumstances should remain unaffected.

2. THE DOCTRINE OF BULL V. UNITED STATES IS INAPPLICABLE BECAUSE THE BARRED EXCISE TAXES FOR 1919–1922 DID NOT ARISE OUT OF THE SAME TRANSACTION AS THE INCOME TAXES FOR 1935 AND BECAUSE RECOVERY OF THE EXCISE TAXES WAS BARRED WHEN THE COMMISSIONER PROCEEDED TO COLLECT THE INCOME TAX

In *Bull* v. *United States*, 295 U. S. 247, the Commissioner had subjected an identical sum of money to both an estate tax and an income tax, by including the sum in a decedent's gross estate and by treating it also as income to the decedent's estate subsequent to his death. The executor contested the correctness of the income tax unsuccessfully before the Board of Tax Appeals. He then paid the income tax and, after filing claim for refund, he brought suit in the Court of Claims. No claim for refund of the estate tax had been filed, and at the time the suit in the Court of Claims was instituted claim for the estate tax was barred by the statute of limitations. This Court held that the income tax was properly and the estate tax improperly imposed. But the Court held that the executor was entitled to have credited against the deficiency of income tax the amount of his overpayment of estate tax with interest under the principle of recoupment and accordingly that the executor was to that extent entitled to judgment. In reaching that conclusion this Court stressed the fact that the Government had given the taxpayer a right of credit or refund of the overpaid estate tax, which, though the taxpayer could not assert it in an

action brought by him at the time suit was begun in the Court of Claims, had accrued and was available to him, since it was actionable and not barred when the Government proceeded against him for the collection of income tax. 295 U. S. at 263. The contrary is true here, for the 1919–1922 excises had long been barred when the Government undertook to collect the 1935 income taxes here involved.

The employment of the doctrine of recoupment in *Bull* v. *United States* as a ground for maintenance of an affirmative action expanded the scope of what was a purely defensive doctrine in the common-law courts of England and of this country[7], and has the effect of granting to a tax-

[7] Recoupment, both at common law and as applied by this Court in the *Bull* case, is a product of judicial action. In this respect it differs from set-off, which is of statutory origin. Recoupment is purely defensive and is confined to matters arising out of the transaction upon which the plaintiff's action is grounded. It goes to the existence of the plaintiff's claim and advances an equitable reason why the plaintiff's claim should be reduced in order that full justice may be done and multiplicity and circuity of action avoided. Since recoupment is purely defensive and arises out of and inheres in the plaintiff's claim and advances reasons why the court should not use its processes to enforce an inequitable claim of the plaintiff, the defense is considered to survive as long as the plaintiff's cause of action exists, although an affirmative action by the defendant upon the subject of the claim may be barred by the statute of limitations. *Wheat* v. *Dotson*, 12 Ark. 699; *Williams* v. *Neely*, 134 Fed. 1 (C. C. A. 8th); *Stow* v. *Yarwood*, 14 Ill. 424; *Pennsylvania R. Co.* v. *Miller*, 124 F. 2d 160 (C. C. A. 5th), certiorari denied, 316 U. S. 676. The Doctrine of Recoupment in Federal Taxation, 28 Va. L. Rev. 577, 579–586 (1941–1942); Counterclaims, 37 Yale L. J.

payer an equitable ground for the recovery of taxes which does not exist under any statute.

The use of the defensive principle of recoupment as an offensive weapon was justified by this Court in the *Bull* case by reason of the fact that the Government in using administrative machinery for the collection of its taxes, and in affording the taxpayer a hearing in the District Courts only after payment, has reversed the usual procedure for the collection of debts.[8] This Court held that in substance the summary administrative proceedings were actions to collect debts alleged to be due the United States and the procedural requirement of payment prior to a suit for refund does not obliterate the substantial right of a taxpayer to rely on a cross demand for credit of the amount which, if the Government had sued him for taxes, he could have recouped against his liability for those taxes.[9]

It is clear, however, that the Court did not mean that recoupment could be used as an

300 (1927–1928); Waterman, Set-Off and Recoupment (1869) 465–478; Restatement, Judgments 217; Tax Refund Claims and the Statute of Limitations, 1 Tax Law Review 45 (1945).

[8] The taxpayer, however, has the right to appeal to the Tax Court prior to assessment or payment of a proposed deficiency in income, estate, and gift tax cases.

[9] If the decision turns upon the substance of the various proceedings, it is clear that the second cause of action in the complaint in the present case in substance seeks a refund of the barred excise taxes for 1919 to 1922. Cf. *Longyear Realty Corp.* v. *Kavanagh* (C. C. A. 6th), decided July 8, 1946 (1946 C. C. H., par. 9317).

offensive weapon by the taxpayer in order to collect a stale claim. Indeed, recovery was predicated on the fact that when the Government proceeded against the taxpayer to collect a second tax on the identical sum of money, refund of the first tax was not barred.[10] 295 U. S. at 263. The converse is true here. When the 1935 tax was assessed and collected, refund of the 1919–1922 taxes had already long been barred.

In *Stone* v. *White*, 301 U. S. 532, rehearing denied, 302 U. S. 777, the Government was

[10] Moreover, it should be noted that the *Bull* case arose under unique circumstances. The income taxes which the taxpayer sought to recover in the Court of Claims in that case had previously been the subject of a proceeding in the Board of Tax Appeals. The taxpayer had originally contested the proposed assessment of income taxes before the Board, but that proceeding occurred in 1925, before there was any direct judicial review of the Board's decisions (Revenue Act of 1924, c. 234, 43 Stat. 253), and when decisions of the Board were not final. A taxpayer, at that time, could pay the deficiency found by the Board and then relitigate the issue by bringing a suit for refund in the District Court or the Court of Claims, as was done in the *Bull* case itself. Under the Revenue Act of 1926, however, the procedure was changed to provide for direct judicial review of Board decisions in the Circuit Courts of Appeals (c. 27, 44 Stat. 9), and to assure finality of such judgments. See *Dobson* v. *Commissioner*, 320 U. S. 489, 497. The Board of Tax Appeals [Tax Court] itself has no jurisdiction to apply principles of equitable recoupment. *Commissioner* v. *Gooch Milling & Elevator Co.*, 320 U. S. 418. Accordingly, had the taxpayer in the *Bull* case brought his proceeding in the Board of Tax Appeals in 1926 or thereafter (instead of 1925 before the Board's decisions were accorded finality), he would not have been able to bring a second proceeding in the Court of Claims. The decision of the Board would have been final, and, under the *Gooch*

allowed to defend on equitable principles where trustees sought to recover a tax which should have been paid by the beneficiary and recovery on the trustees' claim would have inured to the benefit of the beneficiary. The equitable defense was allowed despite the fact that an assessment against the beneficiary was barred, not only when the suit was brought but also when the overpayment was made by the trustees, though not when the assessment against them was made. The two taxes involved in *Stone* v. *White* were on the identical trust income; the issue was simply whether the trustees or the beneficiary owed the tax, and in refusing to allow refund to the trustees the Court simply recognized that a tax on the identical income was owed by the beneficiary. Indeed, the Court's statement that the Government by retaining the tax paid by the trustees was not reviving a stale claim, rested on the ground that there was in reality but a single tax, whether it was nominally imposed on the trustees or the beneficiary. Here, on the other hand, the taxpayer seeks to bring back to life a claim long since expired with respect to

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case, he would not have been entitled to raise any issue of recoupment in the Board.

The fact that the *Bull* case rests upon such unique circumstances that could not arise again, and the fact that Congress has undertaken in 1926 to standardize the litigation pattern as far as possible through the Tax Court (cf. *Dobson* v. *Commissioner*, *supra*) suggest that the doctrine of the *Bull* case which involves the peculiar status of the Board of Tax Appeals during the period 1924–1926, should not be extended.

transactions occurring many years ago. In *Stone* v. *White*, the recoupment claim turned upon the identical event, and no new evidence was required, whereas the so-called recoupment claim here involves facts and transactions that must be established by independent evidence of events occurring in earlier years. If the purpose of a statute of limitations is repose, it is completely frustrated by the decisions below.

Neither *Bull* v. *United States* nor *Stone* v. *White* supports the view that recoupment should be allowed where, as here, the recovery of tax for certain years was barred when the additional tax for a subsequent period was asserted many years later. Such a radical departure from the statutory scheme of limitations with respect to the collection and refund of taxes certainly does not follow from these two decisions.

The doctrine of recoupment as applied by this Court in the *Bull* case retains, as a minimum, the condition essential to its application in suits generally, namely, that the recoupment claim must arise out of some feature of the transaction upon which the claim of the plaintiff is grounded. It may be conceded that the word "transaction" as used in the statement of the doctrine of recoupment in cases involving private parties, and as used in statutory provisions and rules of procedure dealing with the assertion of counterclaims in suits at law or in equity, has been treated as a term of rather broad and flexible meaning. Cf.

Moore v. *New York Cotton Exchange*, 270 U. S. 593, 610; *Lesnik* v. *Public Industrial Corp.*, 144 F. 2d 968, 975 (C. C. A. 2d); *Utilities Service* v. *Walker*, 78 F. 2d 18, 23 (C. C. A. 3d); see also 1 Moore's Federal Practice Under the New Federal Rules 682–684. These cases, however, all dealt with issues and facts that were far removed from the question presented here; none of them involved the revival of stale claims by means of recoupment or any other procedural device.

The court below was of the view that there is little or no help to be had from dictionary or judicial definition or description of the word "transaction" when applied in other situations, to its meaning as used here. Without attempting to settle with exactness what the limits of the word are, the court stated that since the doctrine of recoupment is based on concepts of fairness it saw no reason "for hedging the 'transaction' part of the requirement within close quarters, especially where, as here, there is a logical connection between main claim and recoupment claim." (R. 50, 51.) The logical connection between the main claim in the present case (the claim of the Government for income taxes for 1935) and the recoupment claim (the taxpayer's claim for the barred excise taxes for 1919 to 1922) exists, the court below held (R. 50), in the fact that the barred excise taxes were the same type of tax imposed upon the same nature of merchandise as the excise taxes for the later

periods, the refund of which gave rise to the income tax.

We agree with the view of the court below that recoupment in tax cases presents problems which are not answered by decisions in other fields as to what constitutes the "same transaction". However, the construction which the court below has given to the word "transaction" and the application which it makes of the principle of recoupment offer almost limitless opportunities for circumventing the statute of limitations and the periodical system of federal tax accounting and should not be upheld. As a means for avoiding unusually harsh and inequitable results flowing from a rigid adherence to the statute of limitations the principle of recoupment may serve a desirable end.[11] It is a prin-

[11] Congress has long been aware of the fact that rigid adherence to the statute of limitations frequently produces inequities. House Hearings on Revenue Revision 1927–28, 69–70th Congresses, pp. 148–152, 161–162, 302–303, 307–308, 534–535, 544–545, 547–548, 576–577; House Hearings on Revenue Revision 1934, 73d Cong., 2d Sess., p. 132. By Section 820 of the Revenue Act of 1938 (Appendix, *infra*, pp. 44–49), Congress made provision for an equitable solution of certain classes of hardship cases resulting from application of the statute of limitations. In S. Rep. No. 1567, 75th Cong., 3d Sess., p. 49 (1939–1 Cum. Bull. (Part 2) 779, 815), the Committee on Finance stated:

> The purpose of the statute of limitations to prevent the litigation of stale claims is fully recognized and approved. But it was never intended to sanction active exploitation, by the beneficiary of the statutory bar, of opportunities only open to him if he assumes a position diametrically opposed to that taken prior to the running

ciple without express statutory sanction, however, and should not be applied in such a manner as to result in a direct conflict with the statutory purpose.[12] The manner in which the principle has been applied below does, we submit, result in such conflict.

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of the statute. The Federal courts in many somewhat similar tax cases have sought to prevent inequitable results by applying principles variously designated as estoppel, quasi-estoppel, recoupment and set-off. For various reasons, mostly technical, these judicial efforts cannot extend to all problems of this type. Nor can they provide a uniform, systematic solution of these problems. Legislation has long been needed to supplement the equitable principles applied by the courts and to check the growing volume of litigation by taking the profit out of inconsistency, whether exhibited by taxpayers or revenue officials and whether fortuitous or the result of design.

The legislation here proposed is based upon the following principles:

(1) To preserve unimpaired the essential function of the statute of limitations, corrective adjustments should (a) never modify the application of the statute except when the party or parties in whose favor it applies shall have justified such modification by active inconsistency, and (b) under no circumstances affect the tax save with respect to the influence of the particular items involved in the adjustment.

* * * * *

For a discussion of Section 820 see also: Statute of Limitations, 27 Cal. L. Rev. 409–456 (1938–1939); and Section 820 of the Revenue Act of 1938, 48 Yale L. J. 509–532, 719–778 (1939).

[12] It will be noted that the ultimate tax liability may differ substantially when determined according to the relief provisions of Section 820 of the Revenue Act of 1938 [Internal Revenue Code, Section 3801] and when determined under the principle of recoupment. The fact that Congress has

The doctrine of recoupment has been applied primarily in cases where there has been *inconsistent* treatment for tax purposes of the same item or event, and where a correction according to the statutory method of the erroneous treatment of that item or event is prevented by the statute of limitations.[12] In cases where there has been simply an erroneous treatment of an item or event and that erroneous treatment does not have the effect of imposing a double tax upon that item or event, there is no ground for the application of recoupment in favor of the taxpayer. Cf. *Longyear Realty Corp.* v. *Kavanagh*

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enacted relief provisions on principles other than those of recoupment, the fact that it has not invested the Tax Court with jurisdiction to apply the recoupment doctrine, although the bulk of tax litigation goes to that tribunal, and the fact that the entertainment of the recoupment doctrine by the courts is purely a product of judicial action which promotes circumvention of the statute of limitations in a manner which has no statutory basis and without readily definable boundaries for its application, all lead to the conclusion that the courts, if they possess the power to apply the doctrine at all to support the maintenance of suits against the Government, should exercise that power with restraint.

[12] Recoupment applied in favor of taxpayer: *Bull* v. *United States*, *supra*; *Mills* v. *United States*, 35 F. Supp. 738 (N. D. N. Y.); *Dunigan* v. *United States*, 23 F. Supp. 467 (C. Cls.); *Gooch Milling & Elevator Co.* v. *Commissioner*, 133 F. 2d 131 (C. C. A. 8th), reversed on question of jurisdiction, 320 U. S. 418. Recoupment applied in favor of the Government: *Stone* v. *White*, 301 U. S. 532; *Crossett Lumber Co.* v. *United States*, 87 F. 2d 930 (C. C. A. 8th); *West Virginia Pulp & Paper Co.* v. *McElligott*, 40 F. Supp. 765 (S. D. N. Y.); *First Nat. Bank of Birmingham* v. *United States*, 12 F. Supp. 301 (N. D. Ala.).

(C. C. A. 6th), decided July 8, 1946 (1946 C. C. H., par. 9317); *In re Clayton Magazines*, 77 F. 2d 852 (C. C. A. 2d). To express the thought differently, unless the tax asserted by the Government arises from the same item or combination of acts or events upon which the tax sought to be recouped by the taxpayer was laid, the taxes arise out of different transactions and should not be within the scope of the doctrine of recoupment. It should be borne in mind that the whole concept of recoupment as applied in tax cases is simply a judicial technique for circumventing the statute of limitations where its application might be particularly harsh, namely, where there has been an inconsistent treatment of the same item. The use of recoupment in these circumstances has protected the taxpayer against the imposition of a double liability upon the same item and conversely has protected the Government against the taxpayer's escaping tax entirely upon a particular item. But merely because there has been a narrow departure from the statutory scheme of limitations in order to avoid harsh results in these circumstances is no reason for such sweeping disregard of the statutory scheme as was approved herein by the court below.

The decision in *Dixie Margarine Co.* v. *Commissioner*, 115 F. 2d 445 (C. C. A. 6th), relied on by the court below, is at variance with our position. The facts in that case were similar to those of the present case, and the reasoning of the court was much the same as that of the court

below. We believe that the decision in that case, as in the present case, is plainly erroneous. It may be also noted that appeal in that case was from the Board of Tax Appeals, and the court was therefore without jurisdiction of the recoupment question. *Commissioner* v. *Gooch Milling & Elevator Co.*, 320 U. S. 418.

In the present case the excise taxes over the seven year period from 1919 to 1926 were all upon the manufacture and sale of electric storage batteries, and the statutory provisions under which the taxes were imposed were substantially the same during that time. But these circumstances concededly did not permit the joining of a claim for the excise taxes for the periods from 1919 to June 1922 in the suit which the taxpayer brought in 1928 against the then Collector of Internal Revenue for refund of the excise taxes for the periods from June 1922 to 1926, because, even in 1928, suit for the earlier years had already been barred for almost two years through failure to file a timely claim for refund for those years. With all the greater reason these facts would not support the assertion of a claim for the barred excise taxes in the suit for a refund of the 1935 income taxes, for the income taxes were imposed upon the *refund* of the 1922–1926 excise taxes and hence there was even less relationship between the income taxes and the barred 1919–1922 excise taxes than between the barred excise taxes and the 1922–1926 excise taxes.

The only pertinent transaction in 1935 was the refund. The recoupment claim had no relationship to the refund save the totally irrelevant fact that the refund and the recoupment claim had a common origin in excise taxes paid upon the manufacture and sale of storage batteries. But they were not even the same batteries. It may be further pointed out that there was no inequity in the imposition of the income taxes upon the refund of the 1922 to 1926 excise taxes, for the taxpayer had deducted those excise taxes in its income tax returns for the years 1922 to 1926 and thereby had secured a tax benefit equal to the 1935 income taxes.

If the recoupment principle is to be applied to distinct transactions merely because they grow out of earlier transactions which were similar but not related, the scope of the principle is of wider compass than has been generally understood. We believe the principle should not be so extended. We accordingly submit that the holding of the court below that the present case is within the scope of the principle should be reversed.

II

RECOUPMENT OF THE BARRED EXCISE TAXES IS, IN ANY EVENT, PRECLUDED BY SECTIONS 608–610 OF THE REVENUE ACT OF 1928

The Collector contended in the District Court and in the court below that in any event recoupment in the present case was barred by the provisions of Section 608 (a) and 609 (b) of the

Revenue Act of 1928 (Appendix, *infra*, pp. 42, 43). This contention was rejected by the court below.

Section 608 (a) provides that a refund of any portion of an internal revenue tax, made after the enactment of that Act, shall be considered erroneous if made after the expiration of the period of limitation for filing claim therefor, unless within such period claim was filed. Section 609 (b) provides that a credit, whether made before or after the enactment of the Act, of an overpayment in respect of any tax shall be void if a refund of such overpayment would be considered erroneous under Section 608.

Under Revised Statutes, Section 3228, as amended (Appendix, *infra*, p. 50), claims for refund of the excise taxes for the periods 1919 to 1922 could not have been filed later than 1926. But no claim was ever filed and consequently under Revised Statutes, Section 3226 (Appendix, *infra*, pp. 49–50), no suit could be maintained for such taxes. Hence, under Section 608 (a) a refund of those taxes after the statute of limitations had run in 1926 would have constituted an erroneous refund, which the United States could have recovered under Section 610 (Appendix, *infra*, pp. 43–44), and under Section 609 (b) a credit of the overpayment against the income taxes for 1935 would have been void.

In two cases the Court of Claims, assuming that a taxpayer would otherwise be entitled to a recovery of taxes upon the basis of recoupment,

has held that this right was barred by Sections 608 (a) and 609 (b). *Hall* v. *United States*, 43 F. Supp. 130, certiorari denied, 316 U. S. 664; *Lynchburg Coal and Coke Co.* v. *United States*, 47 F. Supp. 916. In the *Hall* case the taxpayer, who owned an interest in a leasehold estate, had not been allowed depreciation and amortization in its tax returns for years prior to 1929. Upon the sale of the leasehold estate in 1932, the Commissioner reduced the basis for computing profit or loss by the amount of the actual depreciation for the years prior to 1929, and the taxpayer in the suit in the Court of Claims sought to recoup against the income taxes for 1932 the barred overpayments for years prior to 1929, which would have resulted from an allowance of depreciation in those years. In the *Lynchburg Coal and Coke Co.* case, the Commissioner had disallowed depletion for the years 1913 to 1917, which action was shown by a later decision of this Court to have been erroneous. In determining taxpayer's deduction for depletion in later years the Commissioner treated the erroneously disallowed depletion for earlier years as having been allowable, and the taxpayer sought to recoup the barred overpayment for the earlier years. In those two cases, there was a much sounder foundation for the argument that the barred overpayment and the taxes sued for arose out of the same transaction than in the present case.

In reaching the conclusion that recoupment was barred by Sections 608 (a) and 609 (b) the Court of Claims adopted the reasoning of this Court in *McEachern* v. *Rose*, 302 U. S. 56, where the Government had attempted to rely on recoupment as a defense to a taxpayer's suit for refund. In the *McEachern* case the question was whether overpayments of income taxes for the years 1929, 1930 and 1931 were so related to a tax on income which should have been but was not assessed against the taxpayer for the year 1928 as to preclude recovery of the overpayments although collection of the 1928 tax was barred by the statute of limitations. This Court assumed that in the circumstances of that case equitable principles would prevent recovery in the absence of any statutory provisions requiring a different result. However, this Court held that Section 607 and 609 (a) of the Revenue Act of 1928 (Appendix, *infra*, pp. 42, 43) precluded the Government from taking any benefit from the taxpayer's overpayment by crediting it against the unpaid tax whose collection had been barred by limitation.

Section 607 declares that any payment of a tax after expiration of the period of limitation shall be considered an overpayment and directs that it be credited or refunded to the taxpayer if claim therefor is filed within the period of limitation for filing such claim, and Section 609 (a) provides that any credit against a liability

in respect of any taxable year shall be void if any payment in respect of such liability would be considered an overpayment under Section 607. Sections 607 and 609 (a) thus parallel Sections 608 and 609 (b), the first two provisions dealing with the effect of the expiration of the period of limitation against the United States, and the second two provisions dealing with the effect of the expiration of the period of limitation against the taxpayer.

The court below was of the view that the limitation in these sections, upon the use of the doctrine of recoupment, applies only against the Government and not against the taxpayer. It reached this conclusion because of the difficulty in reconciling the decision of *McEachern* v. *Rose, supra,* with that of *Bull* v. *United States, supra,* and because of the supposed public policy involved in protecting taxpayers who pay taxes first and litigate their correctness later.

We agree with the view of the court below that there is some difficulty in reconciling the *McEachern* and the *Bull* and *Stone* v. *White* cases, though it is to be noted that no question as to the effect of Sections 607–609 of the Revenue Act of 1928 was raised or considered in the *Bull* case, and in *Stone* v. *White* as was pointed out in the *McEachern* case itself the statute did not apply because technically at least there were two taxpayers and an overpayment of one could not be

credited against the tax due from the other.[14] But we submit there is no basis for the conclusion that the sections quoted above operate as a limitation only against the Government.

Sections 607–610 of the Revenue Act of 1928 were enacted because Section 1106 (a) of the Revenue Act of 1926, c. 27, 44 Stat. 9, failed to resolve many doubtful questions as to the legal effect of the expiration of the period of limitations prescribed for the assessment or collection of a tax or for the making of a refund or credit, or the bringing of a suit for refund. H. Rep. No. 2, 70th Cong., 1st Sess., pp. 33–34 (1939–1 Cum. Bull. (Part 2) 384, 406). Section 1106 (a) of the Revenue Act of 1926 had provided that the bar of the statute of limitations against the United States and against the taxpayer in respect to any internal revenue tax should operate to bar the remedy and also extinguish the liability, with the condition that no credit or refund in respect of such tax should be allowed unless the taxpayer

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[14] The lower federal courts have uniformly followed *McEachern* v. *Rose* where the Government or the Collector has sought to defeat a recovery of tax by recoupment of a barred deficiency. *American Light & Traction Co.* v. *Harrison*, 142 F. 2d 639 (C. C. A. 7th); *Lyeth* v. *Hoey*, 112 F. 2d 4 (C. C. A. 2d); *Rotenberg* v. *Sheehan*, 48 F. Supp. 584 (E. D. Mo.); *Crawford* v. *Heiner*, 23 F. Supp. 240 (W. D. Pa.). However, the courts have expressed difficulty in reconciling *McEachern* v. *Rose* with *Bull* v. *United States*, *supra*, and *Stone* v. *White*, *supra*; and in the *American Light & Traction Co.* and *Lyeth* cases, *supra*, there were vigorous dissents from the majority rulings.

had overpaid the tax and that no collection in respect of such tax should be made unless the taxpayer had underpaid the tax. The provisions contained in Section 1106 (a) were incorporated in the Revenue Act of 1926 because of the opinion of the Court of Claims in the case of *Toxaway Mills* v. *United States*, 61 C. Cls. 363; H. Rep. No. 356, 69th Cong., 1st Sess., p. 55 (1939–1 Cum. Bull. (Part 2) 361, 380). In that case the Court of Claims had expressed the view that although the statute of limitations was jurisdictional so far as it concerns suits against the United States in the Court of Claims, the statute, in so far as it pertained to the right of the Government to proceed against the taxpayer for additional taxes barred only the remedy and did not extinguish the right, and accordingly that even in a suit by a taxpayer to recover taxes collected after the expiration of the statute of limitations the burden was upon the taxpayer to show that the Government, *ex aequo et bono*, is bound to refund the amount which the taxpayer paid.

There is nothing either in the wording or in the legislative history of Sections 607–610 to indicate that those sections were intended to limit the right of the Government to urge the doctrine of recoupment as a defense to a recovery of taxes and at the same time to preserve to taxpayers a right to employ that doctrine to recover taxes paid by them. Justification for the conclusion that Sections 607–610 are limitations against the

Government only and not against taxpayers is not found, we submit, in a supposed public policy to protect taxpayers who pay taxes first and litigate their correctness later. Indeed, such legislative history as there is indicates a Congressional purpose to place the Government and the taxpayer upon an equal basis.

Under the reasoning in the *Bull* case, the taxpayer was enabled to advance the doctrine of recoupment because he had *failed* to report and pay the income taxes due from him at the time he should have reported and paid them, thus compelling the Commissioner to assert a deficiency against him, which this Court construed as a proceeding to collect a tax to which the defense of recoupment could be made. In that case the taxpayer's failure to report the income was perhaps warranted in view of the fact that the Government had already collected an estate tax on the identical income under what this Court held to be inconsistent action. In the present case the taxpayer likewise failed to make an initial report of the 1935 income in question and forced the Commissioner to assert a deficiency. But if the taxpayer had reported that income in its original return for 1935 and had paid the tax at that time, as it should have done, it would have had no ground for contending to be within the reasoning of the *Bull* case. The theory of the court below puts a premium upon a tax-

payer's failure to report income upon which a tax is properly due, thus compelling the Commissioner to proceed against him. There is, we submit, no public policy which supports this theory.

The court below also held (R. 53) that Sections 608 and 609 of the Revenue Act of 1928 should be interpreted as applying only to cases which arose after its passage. That this was not the intention of Congress is plainly shown by the language of those sections. Section 608 provides that under the circumstances therein stated a refund of any portion of an internal revenue tax "made after the enactment of this Act" shall be considered erroneous. And Section 609 (e) provides that the provisions of that section shall apply to any credit made "before or after the enactment of this Act."

We submit that if this Court adheres to the holding of *McEachern* v. *Rose, supra,* that Sections 607 and 609 (a) of the Revenue Act of 1928 preclude the right of the Government to defeat a recovery of an overpayment of taxes by showing that the taxpayer has underpaid other taxes growing out of the same transaction, assessment of which is barred, then the conclusion is compelled that Sections 608 and 609 (b) preclude a taxpayer from recovering a correct tax by showing that it has overpaid other taxes, the recovery of which is barred by the statute of limitations.

III

IN THIS SUIT AGAINST COLLECTOR ROTHENSIES FOR REFUND OF TAXES PAID TO HIM, THE TAXPAYER MAY NOT RECOUP EXCISE TAXES PAID TO THIS COLLECTOR'S PREDECESSORS IN OFFICE

The taxpayer purports in this case to seek a recovery of only the income taxes paid to Collector Rothensies, against whom the suit has been brought. The taxes collected by this Collector were properly determined and assessed, and no suggestion has been made that the Collector failed to comply with all statutory provisions respecting the collecting of those taxes. The collection of the income taxes in suit was therefore valid and legal. The excise taxes which the taxpayer seeks to recoup were paid to this Collector's predecessors in office.

In *United States* v. *Kales*, 314 U. S. 186, and *United States* v. *Nunnally Investment Co.*, 316 U. S. 258, the Government contended that a suit against a Collector of Internal Revenue is no longer "personal" but merely an expedient for bringing the Government into court. However, this Court rejected the Government's contention.[15]

[15] Those cases involved the question of *res judicata*. With respect to that question only, the result in those decisions has been changed by Section 503 of the Revenue Act of 1942, which added a new provision to Section 3772 of the Internal Revenue Code to the effect that in applying the doctrine of *res judicata* in suits instituted after June 15, 1942, a suit against a Collector shall be treated as if the United States had been a party.

In the *Kales* case, this Court said (pp. 199–200):

> It was payment to the collector which gave rise to the suit against him and limited the amount of the recovery. The judgment against the Collector is a personal judgment, to which the United States is a stranger except as it has obligated itself to pay it. * * *
>
> * * * * * *
>
> By no possibility could the respondent in the suit brought against Collector Woodworth in 1925 recover taxes paid to Collector Grogan in 1920, which she demands here. * * *

The doctrine in those cases plainly forbids a refund from a Collector, whether through recoupment, set-off, or other procedural device, on account of taxes paid to a different Collector.

In the present case Collector Rothensies was a stranger to the payment of the excise taxes collected by his predecessors in office. His predecessors in office, as well as the United States, are strangers to the judgment in the present case. Even under the doctrine of set-off one party to litigation may not defend against the claim of the other party to the litigation by setting up a claim which he may have against a third party who is a stranger to the litigation. Cf. *Dakin* v. *Bayly*, 290 U. S. 143; *Wilson* v. *Codman's Ex'r*, 3 Cranch 193. That is true with even greater force under the doctrine of recoupment where the

cross-claim must arise out of some feature of the same transaction.

The effect of the decision below is to allow a personal judgment against Collector Rothensies because of payments made to his predecessors in office, which, we submit, is contrary to the principle of the *Kales* and *Nunnally* cases.

CONCLUSION

The judgment of the court below is erroneous and should be reversed.

Respectfully submitted,

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SEPTEMBER 1946.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 607. EFFECT OF EXPIRATION OF PERIOD OF LIMITATION AGAINST UNITED STATES.

Any tax (or any interest, penalty, additional amount, or addition to such tax) assessed or paid (whether before or after the enactment of this Act) after the expiration of the period of limitation properly applicable thereto shall be considered an overpayment and shall be credited or refunded to the taxpayer if claim therefor is filed within the period of limitation for filing such claim.

SEC. 608. EFFECT OF EXPIRATION OF PERIOD OF LIMITATION AGAINST TAXPAYER.[16]

A refund of any portion of an internal-revenue tax (or any interest, penalty, additional amount, or addition to such tax) made after the enactment of this Act, shall be considered erroneous—

(a) if made after the expiration of the period of limitation for filing claim therefor, unless within such period claim was filed; or

(b) in the case of a claim filed within the proper time and disallowed by the Commissioner after the enactment of this Act, if the refund was made after the expiration of the period of limitation for filing suit, unless—

[16] The last sentence of Section 608 (b) (2) of the Revenue Act of 1928 was added by Section 503 of the Revenue Act of 1934, c. 277, 48 Stat. 680.

(1) within such period suit was begun by the taxpayer, or

(2) within such period, the taxpayer and the Commissioner agreed in writing to suspend the running of the statute of limitations for filing suit from the date of the agreement to the date of final decision in one or more named cases then pending before the United States Board of Tax Appeals or the courts. If such agreement has been entered into, the running of such statute of limitations shall be suspended in accordance with the terms of the agreement.

SEC. 609 ERRONEOUS CREDITS.

(a) *Credit against barred deficiency.*—Any credit against a liability in respect of any taxable year shall be void if any payment in respect of such liability would be considered an overpayment under section 607.

(b) *Credit of barred overpayment.*—A credit of an overpayment in respect of any tax shall be void if a refund of such overpayment would be considered erroneous under section 608.

(c) *Application of section.*—The provisions of this section shall apply to any credit made before or after the enactment of this Act.

SEC. 610. RECOVERY OF AMOUNTS ERRONEOUSLY REFUNDED.

(a) Any portion of an internal-revenue tax (or any interest, penalty, additional amount, or addition to such tax) refund of which is erroneously made, within the meaning of section 608, after the enactment of this Act, may be recovered by suit brought in the name of the United States, but only if such suit is begun within two years after the making of such refund.

(b) Any portion of an internal-revenue tax (or any interest, penalty, additional amount, or addition to such tax) which has been erroneously refunded (if such refund would not be considered as erroneous under section 608) may be recovered by suit brought in the name of the United States, but only if such suit is begun before the expiration of two years after the making of such refund or before May 1, 1928, whichever date is later.

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 820. MITIGATION OF EFFECT OF LIMITATION AND OTHER PROVISIONS IN INCOME TAX CASES.

(a) *Definitions.*—For the purpose of this section—

(1) *Determination.*—The term "determination under the income tax laws" means—

(A) A closing agreement made under section 606 of the Revenue Act of 1928, as amended;

(B) A decision by the Board of Tax Appeals or a judgment, decree, or other order by any court of competent jurisdiction, which has become final; or

(C) A final disposition by the Commissioner of a claim for refund. For the purposes of this section a claim for refund shall be deemed finally disposed of by the Commissioner—

(i) as to items with respect to which the claim was allowed, upon the date of allowance of refund or credit or upon the date of mailing notice of disallowance (by reason of offsetting items) of the claim for refund, and

(ii) as to items with respect to which the claim was disallowed, in whole or in part, or as to items applied by the Com-

missioner in reduction of the refund or credit, upon expiration of the time for instituting suit with respect thereto (unless suit is instituted prior to the expiration of such time).

Such term shall not include any such agreement made, or decision, judgment, decree, or order which has become final, or claim for refund finally disposed of, prior to ninety days after the date of the enactment of this Act.

(2) *Taxpayer.*—Nothwithstanding the provisions of section 901, the term "taxpayer" means any person subject to a tax under the applicable Revenue Act.

(3) *Related Taxpayer.*—The term "related taxpayer" means a taxpayer who, with the taxpayer with respect to whom a determination specified in subsection (b) (1), (2), (3), or (4) is made, stood, in the taxable year with respect to which the erroneous inclusion, exclusion, omission, allowance, or disallowance therein referred to was made, in one of the following relationships: (A) husband and wife; (B) grantor and fiduciary; (C) grantor and beneficiary; (D) fiduciary and beneficiary, legatee, or heir; (E) decedent and decedent's estate; or (F) partner.

(b) *Circumstances of Adjustment.*—When a determination under the income tax laws—

(1) Requires the inclusion in gross income of an item which was erroneously included in the gross income of the taxpayer for another taxable year or in the gross income of a related taxpayer; or

(2) Allows a deduction or credit which was erroneously allowed to the taxpayer for another taxable year or to a related taxpayer; or

(3) Requires the exclusion from gross income of an item with respect to which tax was paid and which was erroneously excluded or omitted from the gross income of the taxpayer for another taxable year or from the gross income of a related taxpayer; or

(4) Allows or disallows any of the additional deductions allowable in computing the net income of estates or trusts, or requires or denies any of the inclusions in the computation of net income of beneficiaries, heirs, or legatees, specified in section 162 (b) and (c) of this Act, and corresponding sections of prior revenue Acts, and the correlative inclusion or deduction, as the case may be, has been erroneously excluded, omitted, or included, or disallowed, omitted, or allowed, as the case may be, in respect of the related taxpayer; or

(5) Determines the basis of property for depletion, exhaustion, wear and tear, or obsolescence, or for gain or loss on a sale or exchange, and in respect of any transaction upon which such basis depends there was an erroneous inclusion in or omission from the gross income of, or an erroneous recognition or nonrecognition of gain or loss to, the taxpayer or any person who acquired title to such property in such transaction and from whom mediately or immediately the taxpayer derived title subsequent to such transaction—

and, on the date the determination becomes final, correction of the effect of the error is prevented by the operation (whether before, on, or after the date of enactment of this Act) of any provision of the internal-revenue laws other than this section and other than section 3229 of the Revised Statutes, as amended (relating to compromises),

then the effect of the error shall be corrected by an adjustment made under this section. Such adjustment shall be made only if there is adopted in the determination a position maintained by the Commissioner (in case the amount of the adjustment would be refunded or credited in the same manner as an overpayment under subsection (c)) or by the taxpayer with respect to whom the determination is made (in case the amount of the adjustment would be assessed and collected in the same manner as a deficiency under subsection (c)), which position is inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be. In case the amount of the adjustment would be assessed and collected in the same manner as a deficiency, the adjustment shall not be made with respect to a related taxpayer unless he stands in such relationship to the taxpayer at the time the latter first maintains the inconsistent position in a return, claim for refund, or petition (or amended petition) to the Board of Tax Appeals for the taxable year with respect to which the determination is made, or if such position is not so maintained, then at the time of the determination.

(c) *Method of Adjustment.*—The adjustment authorized in subsection (b) shall be made by assessing and collecting, or refunding or crediting, the amount thereof, to be ascertained as provided in subsection (d), in the same manner as if it were a deficiency determined by the Commissioner with respect to the taxpayer as to whom the error was made or an overpayment claimed by such taxpayer, as the case may be, for the taxable year with respect to

which the error was made, and as if on the date of the determination specified in subsection (b) one year remained before the expiration of the periods of limitation upon assessment or filing claim for refund for such taxable year.

(d) *Ascertainment of Amount of Adjustment.*—In computing the amount of an adjustment under this section there shall first be ascertained the tax previously determined for the taxable year with respect to which the error was made. The amount of the tax previously determined shall be (1) the tax shown by the taxpayer, with respect to whom the error was made, upon his return for such taxable year, increased by the amounts previously assessed (or collected without assessment) as deficiencies, and decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax; or (2) if no amount was shown as the tax by such taxpaper upon his return, or if no return was made by such taxpayer, then the amounts previously assessed (or collected without assessment) as deficiencies, but such amounts previously assessed, or collected without assessment, shall be decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax. There shall then be ascertained the increase or decrease in the tax previously determined which results solely from the correct exclusion, inclusion, allowance, disallowance, recognition, or nonrecognition, of the item, inclusion, deduction, credit, gain, or loss, which was the subject of the error. The amount so ascertained (together with any amounts wrongfully collected, as additions to the tax or interest, as a result of such error) shall be

the amount of the adjustment under this section.

(e) *Adjustment Unaffected by Other Items, Etc.*—The amount to be assessed and collected in the same manner as a deficiency, or to be refunded or credited in the same manner as an overpayment, under this section, shall not be diminished by any credit or set-off based upon any item, inclusion, deduction, credit, exemption, gain, or loss other than the one which was the subject of the error. Such amount, if paid, shall not be recovered by a claim or suit for refund or suit for erroneous refund based upon any item, inclusion, deduction, credit, exemption, gain, or loss other than the one which was the subject of the error.

(f) *No Adjustment for Years Prior to 1932.*—No adjustment shall be made under this section in respect of any taxable year beginning prior to January 1, 1932.

Revised Statutes:

SEC. 3226. No suit shall be maintained in any court for the recovery of any internal tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until appeal shall have been duly made to the Commissioner of [the] Internal Revenue, according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof, and a decision of the Commissioner has been had therein: *Provided*, That if such decision is delayed more than six months from the date of such appeal, then the said suit may be brought without first having

a decision of the Commissioner at any time within the period limited in the next section.

SEC. 3228 [as amended by the Revenue Act of 1926, c. 27, 44 Stat. 9, Sec. 1112; Revenue Act of 1928, c. 852, 45 Stat. 791, Sec. 619 (c); Revenue Act of 1932, c. 209, 47 Stat. 169, Sec. 1106 (a)]. (a) All claims for the refunding or crediting of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty alleged to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected must, except as otherwise provided by law in the case of income, war-profits, excess-profits, estate, and gift taxes, be presented to the Commissioner of Internal Revenue within four years next after the payment of such tax, penalty, or sum. The amount of the refund (in the case of taxes other than income, war-profits, excess-profits, estate, and gift taxes) shall not exceed the portion of the tax, penalty, or sum paid during the four years immediately preceding the filing of the claim, or if no claim was filed, then during the four years immediately preceding the allowance of the refund.

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